

**MINUTES  
REGULAR MEETING  
ARIZONA STATE RETIREMENT SYSTEM BOARD**

**Friday, August 18, 2006  
8:30 a.m., MST**

The Arizona State Retirement System (ASRS) Board met in the 10<sup>th</sup> Floor Board Room, 3300 N. Central Avenue, Phoenix, Arizona. Dr. Keith Meredith, Chair of the ASRS Board, called the meeting to order at 8:37 a.m., MST.

The meeting was teleconferenced to the ASRS office at 7660 E. Broadway, Tucson, Arizona 85710.

**1. Call to Order; Roll Call; Opening Remarks**

Present: Dr. Keith Meredith, Chair  
Mr. Michael Townsend, Vice Chair (via teleconference)  
Mr. David Byers  
Mr. Jaime Gutierrez  
Mr. Chris Harris (via teleconference)  
Ms. Anne Mariucci (via teleconference)  
Mr. Karl Polen  
Mr. Lawrence Trachtenberg  
Mr. Steven Zeman

A quorum was present for the purpose of conducting business.

**2. Approval of the Consent Agenda**

**Motion:** Mr. Jaime Gutierrez moved to approve Refunds, Death Benefits and Retirements;

*And*

Approve the System Transfers;

*And*

Approve the minutes of the July 21, 2006, Regular Session of the ASRS Board;

*And*

Approve the Applications and Agreements with the Following Employer;

- Wildcat Secondary School

Mr. Karl Polen seconded the motion.

By a vote of 8 in favor, 0 opposed, 1 abstention, and 0 excused, the motion was approved.

### **3. Presentation, Discussion and Appropriate Action Regarding Notice of Proposed Rulemaking for Article 5, Purchasing Service Credit**

Mr. Pat Klein, Assistant Director, External Affairs, and Ms. Nancy Johnson, Rules Coordinator, addressed the Board regarding the Notice of Proposed Rulemaking for Article 5, Purchasing Service Credit. Ms. Johnson explained that A.R.S. § 38-743, 38-744, 38-745, and § 38-747 allow a current, contributing member of the ASRS to purchase credited service, upon which the ASRS benefits are based. The current rules became effective June 30, 2005. Since that time the ASRS identified several areas in the purchasing service credit rules that needed adjustment in order for the program to conform to federal and state law, run more smoothly, and treat all members fairly.

The rulemaking will:

1. Increase the amount of time a member has to return a signed Irrevocable Payroll Deduction Authorization and provide the circumstances under which exceptions to the time limitations will be made.
2. Amend the document requirements for purchasing military service credit.
3. Clarify the difference between terminating and transferring employment.
4. Define additional terms.
5. Adjust various items of procedure in the process for purchasing service credit.
6. Make technical and clarifying changes to the rules.

**Motion:** Mr. Steve Zeman moved to approve the Notice of Proposed Rulemaking for Article 5, Purchasing Service Credit.

Mr. Jaime Gutierrez seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions and 0 excused the motion was approved.

**4. Presentation, Discussion and Appropriate Action Regarding the 2007 Health Insurance Plan and Recommendation Regarding the Renewal of the PacifiCare (medical plans) and Assurant (dental plans) Contracts**

Mr. Pat Klein addressed the Board regarding the 2007 Health Insurance Plan and Recommendation Regarding the Renewal of the PacifiCare (medical plans) and Assurant (dental plans) contracts. Mr. Klein stated that PacifiCare was awarded up to a 5-year contract beginning January 1, 2005. The 2005 and 2006 plan years were guaranteed as to premiums and plan provisions. This guarantee allowed the

ASRS-enrolled retirees to keep their respective medical plan premiums at 2002 levels. The ASRS was successful at holding premiums constant for five years. However, for 2007, Mr. Klein explained that there would be certain changes to the medical plans and highlighted some of the changes.

Mr. Klein also stated that Assurant was awarded up to a five-year contract beginning January 1, 2006. Assurant was the previous dental vendor and has been the sole dental plans provider since 2002 and has marketed its dental plan to ASRS retirees dating back to 1999. More than 22,000 retirees are enrolled for single or family dental coverage. Historical satisfaction surveys indicate a continuous high level of satisfaction with services, providers and premiums. Assurant's 2007 proposal does not increase premiums nor change plan provisions.

Dr. Keith Meredith called for a motion regarding the medical plans.

**Motion:** Mr. Steve Zeman moved to renew the 2007 contract with PacifiCare (medical plan).

Mr. Dave Byers seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

Dr. Keith Meredith called for a motion regarding the dental plans.

**Motion:** Mr. Jaime Gutierrez moved to renew the 2007 contract with Assurant (dental plan).

Mr. Dave Byers seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

**5. Presentation, Discussion and Appropriate Action Regarding the Budget Requests for the Fiscal Year (FY) 2008 and 2009**

Mr. Anthony Guarino, Deputy Director and Chief Operations Officer, addressed the Board regarding the budget requests for the Fiscal Years (FY) 2008 and 2009. Mr. Guarino explained that major plans and projects to modernize agency services and functions will conclude in FY 08 and that the FY 08/09 request has been structured to transition the agency from a period of high activity and change to a more normal work environment capable of high performance.

To accomplish this, staff and the Operations Committee (OC) recommended additional positions to manage peak service periods, replace temporary workers, and facilitate more uniform service quality and performance. Eight of the fourteen new positions requested have been previously approved by the Board.

Staff and the OC also recommended funding for salary shortfalls, position reclassification and salary adjustments to maximize the agency's ability to hire and retain qualified staff. As with the additional staffing requested, much of this request, nearly half, has been previously approved by the Board.

Formulating the request began from the viewpoint that the recently appropriated FY 07 budget, while nominally adequate for the ASRS to continue its progress toward strategic goals and objectives, still leaves the agency with a lack of experienced knowledge workers, vulnerable to peaks in service demand and turnover.

In addition to human resources, staff and the OC concluded that continued modest investment in technology is important and therefore recommended that \$1.8 million in one-time expenses be appropriated to upgrade the agency's hardware, software and telephone system. Staff and the OC also recommended additional funding for travel, other operating expenses, equipment, and professional outside services.

In total, staff and the OC recommended the Board approve a budget request of \$23,170,300 for FY 08 - a 9.7% increase over the FY 07 appropriation; and \$24,293,800 for FY 09 - a 4.9% over the FY 08 request. The requested increases for FY 08 and 09 can be summarized into four categories:

1. Revisiting priority issues not appropriated in FY 07: 30%
2. Dollars needed for technology upgrades, replacement and contingencies: 35%
3. Newly requested items to address critical needs or anticipated growth in service demand (staffing, professional services, miscellaneous operating expenses, equipment, travel): 22%
4. Dollars to address staff salary and retention issues: 13%

Staff believes that the FY 08/09 budget request represents a reasonable and cost effective utilization of Plan assets. The expected result is the ASRS will meet the goals and objectives outlined in its Strategic Plan with an operating budget that grows slowly and whose cost per member and ratio of staff per member is declining.

**Motion:** Mr. Steve Zeman moved to approve a budget request of \$23,170,300 for FY 08 (an increase of approximately 9.7% over the FY 07 appropriation);

*And*

Approve a budget request of \$24,293,800 for FY 09 (an increase of approximately 4.9% over the FY 08 request).

Mr. Jaime Gutierrez seconded the motion.

By a vote of 9 in favor, 0 opposed, 0 abstentions, and 0 excused, the motion was approved.

## 6. Presentation, Discussion and Appropriate Action Regarding the Total Fund Performance Overview for the Period Ending June 30, 2006

Mr. Terry Dennison, Principal, Mercer Consulting, addressed the Board regarding the Total Fund Performance Overview for the Period Ending June 30, 2006, highlighting specific areas of interest and concern.

Mr. Dennison reported on the Total Fund Performance for the period ending June 30, 2006.

	<b>Quarter</b>	<b>1 Year</b>	<b>3 Years</b>	<b>5 Years</b>	<b>10 Years</b>	<b>Inception</b>
<b>Total Fund</b>	-1.2%	9.8%	11.8%	5.6%	8.7%	10.8%
<b>Benchmark*</b>	-0.7%	8.8%	10.7%	4.9%	7.5%	9.1%
<b>Excess Return</b>	-0.5%	1.0%	1.1%	0.7%	1.2%	1.7%

\* Interim Benchmark: 55% S&P 500, 28% LB Aggregate, 16% MSCI EAFE/ACW ex. US(1), and 1% NCREIF+100 bps.

Note: Interim Benchmark incorporates a proration of 5% real estate.

Policy History:

- 7/1/75-12/31/79 – 40% S&P 500/60% LB Aggregate
- 1/1/80-12/31/83 – 50% S&P 500/50% LB Aggregate
- 1/1/84-12/31/91 – 60% S&P 500/40% LB Aggregate
- 1/1/92-12/31/94 – 50% S&P 500/40% LB Aggregate/10% EAFE
- 1/1/95-6/30/97 – 45% S&P 500/40% LB Aggregate/15% EAFE
- 7/1/97-12/31/99 – 50% S&P 500/35% LB Aggregate/15% EAFE
- 1/1/00-9/30/03 – 53% S&P 500/30% LB Aggregate/17% EAFE
- 10/1/03-present – 53% S&P 500/26% LB Aggregate/15% MSCI EAFE/ACW ex. US(1)/6% NCREIF+100 bps.

(1) MSCI EAFE/ACW ex. US Benchmark is the MSCI EAFE prior to 10/1/05 and the MSCI ACW ex. US thereafter.

## 7. Presentation, Discussion and Appropriate Action Regarding the ASRS Domestic Fixed Income Manager(s) Review

Mr. Gary Dokes, Chief Investment Officer, and Mr. Tom Williams, Fixed Income Portfolio Manager, addressed the Board regarding the ASRS Domestic Fixed Income Manager(s) Review. As of June 30, 2006, the market value of the ASRS fixed income manager(s) assets was \$5.1 billion and represented approximately 25% of the ASRS' total assets. Fixed income assets are currently managed in six portfolios: three active portfolios and three passive/enhanced passive portfolios. Approximately two-thirds of fixed income assets are managed passively. As reported by Mercer, on an intermediate and longer-term historical basis, ASRS fixed income managers have collectively provided Lehman Brothers Aggregate Index-like returns.

## 8. Presentation, Discussion and Appropriate Action Regarding Investment Education Session

Mr. Gary Dokes, Mr. Dan Kapanak, and Mr. Chris Levell, Consultant, New England Pension Consultants, addressed the Board regarding the Investment Education Session. Mr. Dokes stated that over the past 60 days, the Investment Management Division and NEPC have held several meetings to formulate the framework and conduct analysis regarding the ASRS Asset Allocation Study. This Study will be completed in the 4<sup>th</sup> quarter of 2006, and will be the result of discussions with the members of the Investment Committee (IC).

Given that non-IC Trustees may or may not be familiar with or were not members of the Board when the previous ASRS Asset Allocation Study was performed, this investment education session was intended to present materials containing important topics which establish the foundation for strategic (and tactical) investment decision making.

In general, asset allocation studies are intended to utilize modern portfolio theory and investment pragmatism to construct a mix of investment assets that collectively represent a targeted risk/return profile which is anticipated to achieve a fund's macro-level investment goals and objectives.

## **9. Director's Report**

Mr. Matson commented on the federal legislation that passed regarding pension programs.

Mr. Matson also recognized several staff members for their achievements. Within the Investment Management Division (IMD), Mr. Tom Williams, Fixed Income Portfolio Manager, passed exams leading to the Chartered Financial Analyst designation. In addition, Mr. Mike Viteri, Manager of Portfolio and Trading Strategies, was invited to sit on an important S&P advisory panel.

Mr. Matson also wanted to recognize Ms. Martha Rozen, Chief Administrator, and Ms. Sara Orozco, Senior Management Analyst, for their hard work and diligence on the budget and other very important agency projects.

## **10. Possible Presentation Regarding Board Committee Updates**

Mr. Jaime Gutierrez, Vice-Chair, External Affairs Committee, stated that the next External Affairs Committee meeting will occur August 30, 2006.

Mr. Larry Trachtenberg, Chair, Investment Committee, stated that the next Investment Committee meeting will occur August 21, 2006, and the Asset Allocation Study will be discussed.

Mr. Michael Townsend, Chair, Operations Committee, had no comments.

## **11. Board Requests for Agenda Items**

There were no requests for future agenda items.

## **12. Call to the Public**

No members of the public requested to speak.

**13. The next ASRS Regular Board meeting is scheduled for Friday, October 20, at 8:30 a.m., at 3300 N. Central Avenue, 10<sup>th</sup> Floor Board room, Phoenix, Arizona.**

**14. Adjournment of the ASRS Board**

Dr. Meredith adjourned the August 18, 2006 Board meeting at 11:21 a.m.

ARIZONA STATE RETIREMENT SYSTEM

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Anne Schrode, Secretary

Date

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Paul Matson, Director

Date